

The operation of a medical illustration department, which furnishes various photographic, illustrative, and similar services to medical and educational institutions, and an electroencephalography clinic for several hospitals by a foundation which is organized and operated to conduct and support medical and scientific research and is exempt from Federal income taxes under section 501(c)(3) of the Internal Revenue Code of 1954, constitutes an unrelated trade or business within the meaning of section 512 of the Code, the income from which is subject to the tax imposed by section 511 of the Code.

Advice has been requested whether a tax-exempt foundation organized and operated to conduct and support medical and scientific research will be taxable on income received under the circumstances described below.

In addition to its functions in support of medical and scientific research, a foundation, exempt from Federal income taxes under the provisions of section 501(c)(3) of the Internal Revenue Code of 1954, operates a medical illustration department for the use and benefit of medical and educational institutions.

It also conducts an electroencephalography clinic for several hospitals. The services performed by its medical illustration department include the furnishing of medical motion pictures, slides, prints for publication and patient's records, photomicrography, enlarging, photostating, embosographing for movie titles and exhibits, Leroy lettering, varityping and production of medical exhibits. Each organization is billed for any services rendered on a piece work basis or according to the time involved in the process, the charge made being comparable to the standard charges of commercial photography. The electroencephalography clinic conducted by the foundation furnishes electroencephalographs to hospitals and clinics for diagnostic study. The organizations requisitioning such services are billed for the electroencephalograms received and, in the case of one institution, the electroencephalograms are billed to the patients. The volume of production of the department and clinic has increased steadily since their inception. Inventories of supplies are maintained and carried over from year to year. Purchases of equipment have been made and more are contemplated until such time as both the department and clinic are fully equipped.

The gross receipts of the foundation during the taxable year amounted to 24x dollars, of which 18x dollars represented income attributable to operations connected with the medical illustration department and the electroencephalography clinic. Disbursements totaled 21x dollars and were for salaries, expenses incurred in the operations of the department and clinic, research projects, and miscellaneous operating expenses.

Section 511 of the Code imposes a tax on the unrelated

business taxable income of certain organizations exempt from tax under section 501(c)(3) of the Code. The term 'unrelated business taxable income' as defined in section 512 of the 1954 Code means, with certain exceptions, additions, and limitations, the gross income derived by any organization from any unrelated trade or business regularly carried on by it, less allowable deductions directly connected with the carrying on of such trade or business. Section 513 of the Code defines the term 'unrelated trade or business,' in the case of any organization subject to the tax imposed by section 511 of the Code, as any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purposes or functions constituting the basis for its exemption under section 501 of the Code.

Under section 513 of the Code and section 39.442-3 of Regulations 118, made applicable to the 1954 Code by Treasury Decision 6091, C.B. 1954-2, 47, a trade or business regularly carried on is not considered to be substantially related to the activities for which an organization is granted exemption if the income therefrom is disproportionate in amount when considered in connection with the size and extent of the tax-exempt activities, or if its primary purpose is the production of income, or if it is operated in the same manner as a commercial business. Compare Rev. Rul. 54-73, C.B. 1954-1, 160.

Inasmuch as the operation of the foundation's medical illustration department and electroencephalographic clinic is conducted in a manner similar to a commercial undertaking and, in addition, the income derived therefrom is disproportionate when compared with the size and extent of its exempt activities, it is held that the sale of photographic and other related material and the furnishing of electroencephalographs constitutes an unrelated trade or business within the meaning of section 513 of the Code.

Therefore, income derived from the operation of the trade or business is subject to the tax imposed by section 511 of the Code.

While in this case the income of the foundation from the photographic department and the clinic approximate 75 percent of the gross receipts of the foundation, this percentage is not to be taken as a guide or standard as to what may constitute income which is disproportionate when compared with the size and extent of exempt activities in the case of other exempt organizations. In each case the determination should be made on the basis of all the existing facts and circumstances.